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In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY, WEXPRO COMPANY, and ALEX OBLAD, HAROLD BURTON, and CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER SERVICES and UTAH DEPARTMENT OF BUSINESS REGULATION, DIVISION OF PUBLIC UTILITIES,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF UTAH

BRIEF IN OPPOSITION

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BRIEF IN OPPOSITION

INTRODUCTION

The Utah Division of Public Utilities and the Utah Committee of Consumer Services ("Utah") file this Brief in opposition to the petition for certiorari of Utah's principal natural gas utility, Mountain Fuel, and its af-

filiated petitioners ("Mountain Fuel").[1] Mountain Fuel seeks federal review of a Utah Supreme Court decision terminating a gross consumer fraud on Utah's citizens —a fraud the Utah court aptly characterized as a "regulatory outrage", in a manner wholly consonant with Utah's regulatory mandate and public policy without the remotest interference, let alone violation of any federal constitutional prescription.

QUESTIONS PRESENTED

1. Does the fourteenth amendment, the commerce clause or federal preemption prohibit Utah from treating Mountain Fuel's oil and gas properties located in Utah, Colorado and Wyoming as utility properties for rate-making purposes when those properties were explored and developed as utility properties pursuant to a utility exploration program at the risk of Utah's ratepayers?

2. Under the property guarantees of the fourteenth amendment does Mountain Fuel have the constitutional right to conduct an oil and gas exploration program as a utility activity, charge all of the risk of exploration to Utah ratepayers, and keep all the profits from oil discoveries for the sole benefit of Mountain Fuel's stockholders?

3. Does the fourteenth amendment require Utah to grant Mountain Fuel the best of both possible worlds,

[1] The amicus Mountain States Legal Foundation, which purports to present to the Court a "studied reflection" on this case, is financially supported by Mountain Fuel and has on its Board of Directors Wexpro's counsel.

that is, to treat the risk of oil and gas exploration as a utility activity to be borne solely by Utah's ratepayers, but the profits of successful oil discovery as the fruits of free enterprise to be enjoyed exclusively by Mountain Fuel's stockholders?

4. Was Utah constitutionally compelled to accept Mountain Fuel's totally unique "oil and gas method of classification" as the controlling principle for allocating the benefits from Mountain Fuel's oil and gas properties between ratepayer and stockholder interest?

5. Does federal preemption or the commerce clause deprive Utah of regulatory authority over a utility's oil and gas exploration program conducted in Utah and other states as a Utah utility activity at the sole risk of Utah's ratepayers upon the discovery of oil?

6. Is Utah's decision to apply the well-established principle of utility law—gain follows risk—in the allocation of benefits arising from utility activity between ratepayer and stockholder interest to Mountain Fuel's oil and gas properties barred by federal preemption or the commerce clause when those properties whether located in Utah or adjacent states were explored and developed as a Utah utility activity at the sole risk of Utah's ratepayers?

STATEMENT OF THE CASE

The sweeping questions Mountain Fuel attempts to present are contrary to the uncontroverted facts. Mountain Fuel's argument is fundamentally premised on three false factual assertions.

(1) Mountain Fuel claims Mountain Fuel conducted its oil and gas exploration program as a free enterprise, non-regulated activity. On the contrary, Mountain Fuel at all times conducted its exploration program as a utility activity.

(2) Mountain Fuel claims Mountain Fuel's shareholders bore the risk of its exploration for oil and gas. On the contrary, the ratepayers bore all the risk of Mountain Fuel's exploration for oil and gas.

(3) Mountain Fuel claims the decision of the Utah Supreme Court amounts to retroactive reclassification, whatever that is. On the contrary, the Utah decision does not recapture one dime of oil profits taken by Mountain Fuel's shareholders before the initiation of these proceedings, and only classifies as utility properties for future rate-making purposes, properties that always were and should have been so classified.

1. *Mountain Fuel always conducted its oil and gas exploration program as a utility activity.*

From the inception, Mountain Fuel conducted its oil and gas exploration program as a Utah utility activity. Unlike major oil companies, independent producers, or indeed other utilities, Mountain Fuel did not put up its shareholders' money and take its chances. Mountain Fuel let Utah ratepayers put up their money and take the chance of finding oil or gas. All of the wildcat acreage Mountain Fuel explored was acquired

by Mountain Fuel in its utility accounts and included in Mountain Fuel's rate base on which Mountain Fuel's ratepayers paid a regulated rate of return. (R. 700.)[2] If leases proved unsuccessful and were cancelled, the loss on such cancellation was charged to Mountain Fuel's ratepayers. (R. 687-88.) All preliminary exploratory work was charged as an expense in Mountain Fuel's rates. Most important of all, every single dry hole was charged to Mountain Fuel's Utah ratepayers. (Utah P.S.C. Case Nos. 2906 (1947), 4797 (1960) and 6369 (1972); DIV-1; MFS-8; R. 312-14, 687-89, 691, 701, 2394.) From 1947 until 1974 Mountain Fuel recovered all of its expense for the exploration and development of oil and gas through charges in its rates to Utah ratepayers and in fact the amount recovered actually exceeded the amount of expense incurred by Mountain Fuel in its exploration activities. (Utah P.S.C. Case Nos. 6668 and 6791 (1974); R. 694.)[3] Mountain Fuel did conduct its exploration program in states other than Utah, but the uncontroverted facts were that that exploration program, wherever conducted—in Utah, Wyoming, or Colorado—was con-

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[2] The following abbreviations are used for the purpose of citation in this brief: (1) "R." refers to the transcript page numbers from evidentiary hearings before the Public Service Commission; (2) "Ord." by date and without case number refers to the orders of the Public Service Commission in this case; (3) orders by case number and date only refer to Commission orders in the cited case, and (4) citations to exhibits are to the exhibit number used in this proceeding; Mountain Fuel exhibits are referred to as MFS—; Division of Public Utilities exhibits are referred to as DIV—; and Salt Lake County exhibits are referred to as SLC—.

[3] For accounting purposes, the costs of unsuccessful exploration are expensed and the costs of successful exploration are capitalized. Mountain Fuel's shareholders only put their money up after exploration proved to be successful.

ducted as a Utah utility activity, and Mountain Fuel only attempted to transform its exploration program from a utility to a non-utility classification after oil and gas were discovered.

2. *It was only after the successful discovery of oil that Mountain Fuel attempted to reclassify its oil properties as non-utility properties under Mountain Fuel's wholly-unique oil and gas method of classification.*

While Mountain Fuel explored for oil and gas as a utility activity, it attempted to transform successful oil discoveries into non-utility properties beyond regulatory control under its wholly-unique oil and gas method of classification. (R. 1030-31.) Under Mountain Fuel's oil and gas method of classification, a successful exploration was classified as an oil or gas well based on the type of hydrocarbon discovered. (MFS-5; R. 71-72, 422, 455, 559, 1030-31.) If a commercial discoverey produced pipeline quality gas, the well and related properties were capitalized in Mountain Fuel's utility accounts and the gas distributed to Mountain Fuel's ratepayers as cost-of-service gas, which included, of course, a profit or rate of return on Mountain Fuel's capital investment. (MFS-5; R. 61.) All other hydrocarbons, whether crude oil, condensate, or natural gas liquids were classified by Mountain Fuel as oil properties and capitalized by Mountain Fuel in its non-utility accounts. (R. 1030-31; 1045.) Mountain Fuel kept all of the profits from these oil properties exclusively for Mountain Fuel's shareholders. (SLC-1 at 8; R. 1030-31.)

Mountain Fuel's oil and gas method of classification was thus used by Mountain Fuel for two purposes. First, it was used by Mountain Fuel as a test of Utah's regulatory jurisdiction. That is, under Mountain Fuel's oil-and-gas method of classification, Mountain Fuel claimed Utah lost regulatory jurisdiction upon Mountain Fuel's discovery of hydrocarbons other than pipeline gas. (Ord. 4/11/78 at ¶¶ 11, 52, 108.) Mountain Fuel also used its oil and gas method of classification as a principle of allocating the benefits of its exploration program between ratepayer and stockholder interests. (SLC-1 at 8; R. 1030-31.) Although all of Mountain Fuel's exploration program for oil and gas was conducted as a unitary utility activity, Mountain Fuel's ratepayers only benefited upon the discovery of gas.[4] The ratepayers benefited upon gas discoveries by having such gas included in their rates at a cost-of-service price rather than field or market prices. The cost-of-service price, of course, included a profit for Mountain Fuel's stockholders. Although Mountain Fuel conducted its exploration as a utility activity under its oil and gas method of classification, it kept all oil discoveries

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[4] Utah did not argue that Mountain Fuel's exploration program had failed to benefit Utah ratepayers. Utah's argument was that Mountain Fuel's shareholders, under Mountain Fuel's oil and gas method of classification, realized huge oil profits to which they were not entitled. Mountain Fuel, moreover, in its petition, grossly overstates the benefits received by Utah's ratepayers. Mountain Fuel, in its petition, for instance, claims that Utah ratepayers received some $93.8 million in tax deductions from Mountain Fuel's exploration program. (Petition at 9.) But the $93.8 million includes all of Mountain Fuel's costs of unsuccessful exploration that were, in turn, charged to Utah's ratepayers to the tune of $57 million. Simply, Mountain Fuel claims that it was to the ratepayers' benefit to pay for the cost of drilling dry holes.

for the sole benefit of Mountain Fuel's stockholders. In short, Mountain Fuel used its oil and gas method of classification to achieve the best of both possible worlds. When it was involved in the high-risk business of exploring for oil and gas, it conducted that business as a utility activity and charged those risks to Utah's ratepayers. When the risk of exploration was eliminated and it had discovered oil, Mountain Fuel attempted to convert its oil wells to non-utility properties and to keep the benefits or profits from those properties as the fruits of free enterprise exclusively for its stockholders. To look at the consequences of Mountain Fuel's oil and gas method of classification in the harsh light of economic reality, it was Mountain Fuel's position that Mountain Fuel was able to develop over $250 million in oil reserves for the sole benefit of Mountain Fuel's stockholders without drilling a single dry hole.

Mountain Fuel's claim that its oil and gas method of classification was required by utility regulation and that its rejection will have economic and litigation repercussions beyond this one proceeding are wholly false. Mountain Fuel's oil and gas method of classification was not required by any rule or regulation. (R. 230, 231, 1029.) Indeed it was only after the initiation of these proceedings in 1977 that Mountain Fuel's oil and gas method of classification was ever reduced to writing. (Ord. 4/11/78 at ¶ 22; MFS-4, 5; R. 286.) Mountain Fuel's own chief executive officer acknowledged that while Mountain Fuel was required under standard utility regulation to keep separate utility and non-utility accounts, there was no rule or regulation that required

the division of Mountain Fuel's oil and gas properties between such accounts on the basis of Mountain Fuel's oil and gas method of classification. (R.231.) The reason there was no such accepted rule or regulation is because Mountain Fuel's oil and gas method of classification was wholly unique not only to the gas utility industry but to the entire oil and gas industry. No other company in the United States has ever used Mountain Fuel's oil and gas method of classification as a test of regulatory jurisdiction or as a principle for allocating benefits between ratepayer and shareholder interests. (R. 295-96; 459-61; 870-71; 2707.) The uniqueness of Mountain Fuel's oil and gas method of classification now belies Mountain Fuel's claim that Utah's rejection of that method of classification raises constitutional questions of substance for this Court's consideration or to put the issue in different perspective, belies Mountain Fuel's necessary position that the consequences of its oil and gas method of classification were compelled under the United States Constitution.

3. *Utah's ratepayers bore all of the risk of Mountain Fuel's exploration for oil and gas.*

The risk of exploration for oil and gas is the risk of not finding oil or gas. All of the risk of oil and gas exploration is reflected in the cost of unsuccessful exploration and all of the cost of unsuccessful exploration by Mountain Fuel was charged by Mountain Fuel in its rates to Utah ratepayers. From 1947 until 1972 Utah ratepayers did not merely pay Mountain Fuel for the gas they used but also paid all of Mountain Fuel's cost for unsuccessful exploration—every single dry hole.

(Utah P.S.C. Case Nos. 2906 (1947), 4797 (1960) and 6369 (1972); DIV-1; MFS-8; R. 312-14, 687-89, 691, 701, 2394.)

Mountain Fuel's shareholders or non-utility accounts were not required to pay one single dime toward Mountain Fuel's cost of unsuccessful exploration until 1972. In 1972, the Utah Public Service Commission for the first time required Mountain Fuel's non-utility accounts, representing the interest of Mountain Fuel's shareholders, to pay $300,000 a year toward Mountain Fuel's cost of unsuccessful exploration. (Utah P.S.C. Case No. 6369 (1972); R. 688.) In 1974 Mountain Fuel's non-utility accounts were required to pay 1/3 of such cost (Utah P.S.C. Case No. 6668 (1974) and finally in 1976, only one year before the Wexpro transactions, Mountain Fuel's stockholders were required to bear 50% of Mountain Fuel's risk of exploration. (Utah P.S.C. Case No. 7113 (1975); R. 688-89.)

From 1947 through 1974 the amount charged in Mountain Fuel's rates to Utah's ratepayers for the cost of unsuccessful exploration exceeded by over $3 million the amount Mountain Fuel actually spent or incurred for unsuccessful exploration. (Utah P.S.C. Case Nos. 6668, 6791 (1974); R. 694.) In short, through 1974, Utah ratepayers bore all of Mountain Fuel's risk of exploration for oil and gas. By 1974 Mountain Fuel had already completed its major oil and gas discoveries. (Ord. 4/11/78 at ¶¶ 27-29.) Of the $250 million in oil and gas reserves that Mountain Fuel attempted to transfer from its non-utility accounts to Wexpro in December

of 1976, over 96% of those reserves had been discovered by 1974. (Ord. 4/11/78 at ¶¶ 27-29; DIV-2; R. 1012, 1025.)

It is true that in 1972 Mountain Fuel's non-utility accounts were required to commence making token contributions to Mountain Fuel's exploration risk and that from 1972 through 1976 Mountain Fuel's shareholders, through its non-utility accounts, finally paid over $8 million toward Mountain Fuel's risk of exploration. (DIV-1.) In the same 1972-1976 period, however, Mountain Fuel's ratepayers paid $17 million toward Mountain Fuel's cost of unsuccessful exploration (*Id.*) and from 1947 through 1976 the ratepayers paid over $57 million. (Utah P.S.C. Case Nos. 2906 (1947), 3275 (1948), 3511 (1950), 3650 (1951), 3972 (1953), 4392 (1957), 4797 (1960) and 5907 (1968); DIV-1; MFS-8.) More importantly, the shareholders' contribution that was finally required was only paid out of the enormous profits from oil properties that had been discovered at ratepayer risk. In 1972 Mountain Fuel had net profits from its non-utility oil properties of $1.6 million; in 1973, $2.3 million; in 1974, $7.2 million; in 1975, $14.4 million; and in 1976, the year before Wexpro, $24 million. (SLC-1 at 8.) In the period, 1972-1976, when Mountain Fuel was finally required to pay $8 million toward Mountain Fuel's cost of unsuccessful exploration it realized over $47 million in net profits from the oil properties that had been developed at the sole risk of Mountain Fuel's ratepayers. Mountain Fuel's costs of unsuccessful exploration were, thus, either directly paid by Utah ratepayers or paid from the prof-

its of oil properties that had been developed at the sole risk of Utah ratepayers. The total risk, therefore, of Mountain Fuel's exploration and development of oil and gas was in economic reality borne by the Utah ratepayers of Mountain Fuel. It was this consumer fraud that was terminated by the Utah decision that Mountain Fuel now claims warrants review of this Court.

Mountain Fuel's claim, a claim made for the first time in this Court, that the risk of exploration charged to ratepayers was conditioned on the requirement that Mountain Fuel discover and produce cheap gas, is wholly false. The ratepayers' obligation to pay all of Mountain Fuel's cost of unsuccessful exploration was not conditioned in any way. If Mountain Fuel had not discovered a single cubic foot of gas, Mountain Fuel and its stockholders would not have had to reimburse or defray any of the burden placed on Utah's ratepayers. The record is wholly devoid of any such administrative requirement. There was simply no money-back guarantee.

4. *The Wexpro transactions.*

Effective January 1, 1977, Mountain Fuel attempted to once and for all remove the oil and gas properties held in its non-utility accounts from what it perceived as the jeopardy of Utah regulation. Mountain Fuel created a wholly-owned subsidiary, Wexpro, and attempted to transfer all of the oil and gas reserves held in its non-utility oil accounts with a market value in excess of $250 million to Wexpro. Mountain Fuel also attempted to have Wexpro enter into a joint exploration arrangement with Mountain Fuel to explore over 2.9 million acres of oil and gas leases held in Mountain Fuel's utility accounts. The transfer of Mountain Fuel's oil and gas properties to Wexpro at book value in exchange for all of Wexpro's outstanding stock was reflected in a Purchase and Sale Agreement. (MFS-1.) The Purchase and Sale Agreement, as amended, required Wexpro to resell all of the gas produced from the transferred properties to Mountain Fuel at cost-of-service prices. (MFS-4.) The Purchase and Sale Agreement also gave Mountain Fuel an option to purchase gas produced by Wexpro on new acreage at market prices. The joint exploration arrangement was reflected in a Joint Exploration Agreement between Mountain Fuel and Wexpro. (MFS-2, 5.)

The respondents initiated the proceedings below to attack the Wexpro transactions. Utah claimed that the Commission had jurisdiction over the oil and gas properties held in Mountain Fuel's non-utility accounts, that such properties were utility properties, and that they should be rolled in or included in Mountain Fuel's utility accounts for rate-making purposes. The Public Service Commission, in a 2-1 decision,[5] ruled against respondents, and they appealed to the Utah Supreme Court.

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[5] The Commission Report & Order set forth at pages 1 to 95 of Appendix B to Mountain Fuel's petition does not represent the independent product of the Public Service Commission but was adopted verbatim from the order proposed by Mountain Fuel, an adjudicatory practice previously critized by this Court. **U.S. v. El Paso Natural Gas Co.**, 376 U.S. 651 (1964).

5. The decision of the Utah Supreme Court.

The Utah Supreme Court reversed the Utah Public Service Commission. The holdings of the Utah Supreme Court below can be divided for the purpose of the petition for certiorari between holdings addressed to issues relating to the oil and gas properties held in Mountain Fuel's non-utility accounts and holdings addressed to the option of Mountain Fuel to purchase gas produced by Wexpro from newly-acquired acreage at market prices and Wexpro's regulatory status. The holdings of the Utah Supreme Court addressed to the oil and gas properties were by far the most important and were the focus of the court's decision. These holdings were clear and final.

The Utah Supreme Court held with regard to the oil and gas properties held in Mountain Fuel's non-utility accounts (1) such properties were utility properties (App. A12),[6] and (2) such properties should be included in Mountain Fuel's utility accounts for rate-making purposes (App. A8, 9). The Supreme Court of Utah categorically rejected Mountain Fuel's oil and gas method of classification as a proper test of Utah regulatory jurisdiction or as a proper principle for the allocation of benefits arising from Mountain Fuel's oil and gas exploration program between ratepayer and shareholder interest. The bottom line of the Utah Supreme Court's decision was that the net profits from Mountain Fuel's oil properties beyond all costs associated with their production, including the cost of capital, should be applied to the benefit of Utah ratepayers through a reduction in their future rates (App. A8, 9). The court held the ratepayers were to receive those net profits because the ratepayers and not Mountain Fuel's shareholders had assumed the risk of exploration for oil and gas (App. A8). The Utah court reached the same result as Michigan and California. *Re Michigan Consolidated Gas Co.*, 78 P.U.R.3d 321 (Mich. Pub. Serv. Comm'n 1968); *Re Pacific Gas & Electric Co.*, 97 P.U.R.3d 321 (Cal. Pub. Serv. Comm'n 1972), and implicitly followed the thoughtful decision of the Circuit Court of Appeals for the District of Columbia in *Democratic Central Committee v. Washington Transit Commission*, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974).

The Utah Supreme Court's holding with regard to Mountain Fuel's option to purchase gas from Wexpro at market prices was occasioned by the past practices of Mountain Fuel. When gas reserves wound up in Mountain Fuel's non-utility accounts as a result of Mountain Fuel's oil and gas method of classification, Mountain Fuel added insult to injury by reselling that gas to Mountain Fuel's utility accounts at market prices, and then passing on those market prices as an expense in its rates to Utah ratepayers. The Supreme Court of Utah, in light of these past practices, adopted a "no-profit-to-affiliates" rule which prohibited such intra-company profits from being included in consumer rates, and applied that rule to the Mountain Fuel-Wexpro option so as to prevent any profit realized by Wexpro

[6] The citation "App. A" refers to the Utah Supreme Court's decision set forth in Appendix A to Mountain Fuel's Petition for a Writ of Certiorari.

under that option from being passed on to Mountain Fuel's ratepayers. The Utah Supreme Court also held that Wexpro, by reason of its relationship as a wholly-owned subsidiary of Mountain Fuel and the unique relationship between Mountain Fuel and Wexpro created under the Purchase and Sale Agreement and the Joint Exploration Agreement, was, under Utah law, a public utility.

While the Supreme Court's holding with regard to the Mountain Fuel-Wexpro option and Wexpro's status as a public utility are clear, their finality for the purpose of certiorari is less certain. The Supreme Court not only set aside the Purchase and Sale Agreement and the Joint Exploration Agreement, the Supreme Court of Utah left open the question of whether Wexpro is to exist at all. Specifically, in footnote 8, the Utah court said:

> There is further posed the serious issue of whether it is in the public interest for Mountain Fuel to divide its utility function between itself and a subsidiary. Relevant factors to be considered in this inquiry include any potential administrative inconvenience caused by the necessity of regulating two corporate entities performing, in essence, a singular utility function; and additional costs and expenses affecting the rate base.

Simply put, the question of whether there is going to be a Wexpro remains a Utah regulatory issue.

6. *The decision of the Utah Supreme Court does not confiscate any property of Mountain Fuel or its shareholders, interfere with interstate commerce or conflict with federal energy policy.*

Mountain Fuel's attempt to concoct "substantial Federal questions" out of the decision below is premised on fundamental mischaracterization of the court's decision. The Utah Supreme Court's decision did not confiscate anything. The Utah Supreme Court merely held that oil and gas properties that had been developed under a utility program at the risk of Utah ratepayers were utility properties on which Mountain Fuel was only entitled to a regulated rate of return, and that net profits beyond that regulated rate of return should be credited to Mountain Fuel's ratepayers to reduce rates. What Mountain Fuel's shareholders are entitled to have constitutionally protected and what will be protected under the decision of the Utah Supreme Court is their capital investment in Mountain Fuel's utility oil properties.

The decision below does not "retroactively reclassify" anything. Mountain Fuel's attempt to inject the slogan "retroactive reclassification" to support its "confiscation" argument is sophistry. Nothing in the Utah court's holding will affect anything prior to the institution of the *Wexpro* proceeding. There is no impact on rates received or revenues realized under any prior Commission order. Mountain Fuel will keep every dime of the $57 million it received for the cost of unsuccessful exploration. It will keep every dime of oil profits it received through the end of 1976—profits amounting to over $47 million. The court's decision will only affect rates and revenues after the initiation of the *Wexpro* case.

The Utah decision did not regulate the price, pro-

duction or profits of oil and gas sold in interstate commerce. The Utah decision did not remotely attempt to regulate the price at which oil or gas is sold by Mountain Fuel or Wexpro to others, nor does it even regulate the price at which Wexpro sells gas to Mountain Fuel under the Mountain Fuel-Wexpro option. All that the Utah Supreme Court held with regard to the Wexpro-Mountain Fuel sales is that any profits realized by Wexpro could not be included as charges in Mountain Fuel's rates to Mountain Fuel's customers under the "no-profit-to-affiliates" rule.

By holding that the unique relationship between Mountain Fuel and Wexpro resulted in Wexpro being classified as a public utility, the Utah Supreme Court did not hold and did not even state that independent parties other than Wexpro would be classified as public utilities by reason of their normal business relationships with Mountain Fuel. The Utah Supreme Court did not attempt to regulate the price of natural gas sold to Mountain Fuel for resale by independent parties or to classify such independent suppliers as public utilities. Indeed, Utah has a statute that expressly exempts such independent suppliers from classification as a public utility. Thus, section 54-2-1(30) provides in material part:

> Such person, company, corporation or association selling or exchanging such surplus product under such authorized contract shall not thereby become a public utility within the meaning of this act, nor shall it be subject to the jurisdiction of the commission. . . . § 54-2-1 (30), U.C.A. 1953.

And finally, the Utah Supreme Court's decision does not prevent any independent party from engaging in joint exploration with Mountain Fuel under the penalty of being classified as a public utility. Wexpro was not an independent party. Wexpro was created as a wholly-owned subsidiary of Mountain Fuel for the sole business purpose of receiving all of the oil and gas properties held in Mountain Fuel's non-utility accounts and to explore with Mountain Fuel the valuable wildcat acreage held in Mountain Fuel's utility accounts. It was intimately involved in an attempt to secure with finality hundreds of millions of dollars of oil and gas reserves that had been developed at ratepayer risk for the benefit of Mountain Fuel's shareholders, and to grab enormously valuable exploration rights on over 2.9 million acres of oil and gas leases held in Mountain Fuel's utility accounts. There was nothing independent about Wexpro, and there is nothing in the *Wexpro* decision by the Utah Supreme Court that regulates, threatens or interferes with independent producers or sellers.

REASONS FOR DENYING THE WRIT

1. *The Utah Supreme Court's decision does not raise any issue of constitutional confiscation.*

Mountain Fuel's claim of constitutional confiscation amounts to a claim that Mountain Fuel is constitutionally entitled in its exploration program to the best of both possible worlds—the worlds of utility regulation and private enterprise. Mountain Fuel under its "oil" and "gas" method of classification asked to be treated

as a utility when it was engaged in the risk of exploration. It wanted to be treated as a utility by having its wildcat acreage capitalized in its utility accounts as property held for future use, when it incurred losses on wildcat acreage by including as a charge in its rates the expenses of cancelled leases, when it did geophysical and seismic work preparatory to exploration, and when exploration was unsuccessful and resulted in dry holes. But Mountain Fuel wanted its exploration to be transformed into a private enterprise as soon as oil was discovered. It wanted to be treated as a private enterprise under its "oil" and "gas" method of classification where the benefits of profits of its oil properties were concerned.

The simple answer to Mountain Fuel's claim of constitutional confiscation is that the constitution does not guarantee a utility the best of both possible worlds. The constitution does not guarantee a utility can charge its ratepayers the cost of service for the gas they receive, in addition can charge its ratepayers for all the cost of unsuccessful exploration, and then keep the unregulated return from oil properties discovered through such exploration solely for the benefit of stockholders.

Under the Utah Supreme Court's decision Mountain Fuel and Mountain Fuel's stockholders receive the constitutional protection to which they are entitled. What Mountain Fuel's stockholders are entitled to have protected, and what will be protected under the Utah Supreme Court's decision, is their capital investment. ***Federal Power Commission v. Hope Natural Gas Co.,***

320 U.S. 591 (1944); *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934); *see also, Nebbia v. People of the State of New York*, 291 U.S. 502 (1934). The roll-in of Mountain Fuel's utility oil properties and associated revenues and expenses under the Utah Supreme Court's decision will result in the full protection of Mountain Fuel's stockholders' capital investment in utility oil properties. All the costs associated with the operation and production of Mountain Fuel's utility oil properties, including a rate of return or profit on the stockholders' capital investment, will inure to the benefit of Mountain Fuel's stockholders. That is the protection required by the constitution and that is the protection that Mountain Fuel's stockholders will receive under the court's decision. What the stockholders will not receive are the net profits of Mountain Fuel's utility oil properties beyond all costs associated with their production. Beyond such costs those profits will be allocated to its ratepayers under the Utah Supreme Court's decision, for those profits are profits attributable to the risks of exploration, the risks that were exclusively borne by Mountain Fuel's ratepayers.

This Court has squarely held that there is no constitutional right to non-regulation and certainly there is no constitutional right to the continued acceptance of Mountain Fuel's oil and gas method of classification that arbitrarily and improperly removed utility properties from the jurisdiction of the Commission. ***Federal Power Commission v. Natural Gas Pipeline***, 315 U.S. 575 (1942); *Nebbia v. People of the State of New York, supra; Cottonwood Mall Shopping Center v. Utah*

Power & Light Co., 440 F.2d 36 (10th Cir. 1971). The argument that Mountain Fuel makes was precisely the constitutional attack made against the Natural Gas Act of 1938 which for the first time placed natural gas pipelines under federal regulation and made such pipelines subject to a regulated rate of return. The Court made short shrift of that argument and stated, "[T]he business . . . is not any the less subject to regulation now because the government has not seen fit to regulate it in the past." *Federal Power Commission v. Natural Gas Pipeline, supra*, at 583.

The roll-in of oil properties, revenues and expenses is not confiscation at all, but is an application by the Utah Supreme Court of the controlling principle uniformly followed by courts and commissions in allocating benefits arising from utility activities between ratepayer and stockholder—gain follows risk. *Democratic Central Committee v. Washington Transit Commission*, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974); *Bebchick v. Washington Transit Commission*, 485 F.2d 858 (D.C. Cir. 1973); *New York Water Service Corp. v. Public Service Commission*, 12 App. Div.2d 122, 208 N.Y.S.2d 857 (1960); *El Paso Natural Gas Co.*, Docket No. CP75-362 (FERC 1977); *Re Michigan Consolidated Gas Co.*, 78 P.U.R.3d 321 (Mich. Pub. Serv. Comm'n 1968); *Re Wyoming Gas Co.*, 40 P.U.R.3d 509 (Wyo. Pub. Serv. Comm'n 1961). The principle that he who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom, *Democratic Central Committee, supra*, at 806, does not raise an issue of con-

fiscation, but is valid regulation of public utility activity in the public interest. This principle of allocation has been adopted without exception by every single judicial and administrative decision in every jurisdiction which has ever addressed the question. *Bebchick v. Washington Transit Commission, supra; New York Water Service Corp. v. Public Service Commission, supra; El Paso Natural Gas Co., supra; Re Michigan Consolidated Gas Co., supra; Re Wyoming Gas Co., supra.* The claim of "confiscation" is a red herring.

2. *The Utah Supreme Court's decision does not raise any issue of undue burden or obstruction of interstate commerce.*

Mountain Fuel's claim the Utah Supreme Court decision burdens or obstructs interstate commerce is wholly without merit.

(a) Mountain Fuel attempts to argue that the Utah Supreme Court's holding addressed to the Mountain Fuel-Wexpro option obstructs commerce by regulating the price of interstate sales of gas from Wexpro to Mountain Fuel.[7] The decision below does nothing of the sort. Rather, the Utah Supreme Court requires the Public Service Commission to allow in retail rates only the cost of service on gas sold by Wexpro to Mountain Fuel. The court does so under the "no-profit-to-affiliates" rule, applying the well-established principle that

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[7] While the question whether Wexpro is to exist at all is still open, see § 5, supra, there is no commerce clause issue raised by this case whether Wexpro exists or not. For the purpose of respondents' argument respondents assume that Wexpro will be in business.

shareholders should not be able to make a profit at the expense of ratepayers on transactions between affiliated companies where there is no arm's-length bargaining. Regardless of whether or not Wexpro's gas comes from inside or outside Utah, this holding is fully in line with constitutional doctrine established by this Court. This Court has consistently held a state, in retail ratemaking, may determine a reasonable charge on interstate sales of natural gas between affiliates without violating the commerce clause. In *Lone Star Gas Co. v. Texas*, 304 U.S. 224 (1938), this Court expressly rejected the argument that a determination by the Texas commission of a reasonable rate for gas sold interstate to a utility by an affiliated pipeline company was invalid under the commerce clause. *Lone Star Gas* was consistent with and followed the rule laid down in *Dayton Power & Light Co. v. Public Utilities Commission of Ohio*, 292 U.S. 290 (1934) and *Western Distributing Co. v. Public Service Commission of Kansas*, 285 U.S. 119 (1932). In *Western Distributing*, the Court explained why a state inquiry into the reasonableness of a charge by an affiliate for gas sold interstate does not circumvent paramount federal authority over interstate commerce:

> Those in control of the situation have combined the interstate carriage of the commodity with its local distribution in what is in practical effect one organization. There is an absence of arm's length bargaining between the two corporate entities involved, and of all the elements which ordinarily go to fix market value. The opportunity exists for one member of the combination to charge the other an unreasonable rate for the gas furnished and thus to make such unfair charge in part the basis of the retail rate. The state authority whose powers are invoked to fix a reasonable rate is certainly entitled to be informed whether advantage has been taken of the situation to put an unreasonable burden upon the distributing company, and the mere fact that the charge is made for an interstate service does not constrain the Commission to desist from all inquiry as to its fairness. Any other rule would make possible the gravest injustice, and would tie the hands of the state authority in such fashion that it could not effectively regulate the intrastate service which unquestionably lies within its jurisdiction. *Western Distribution Co., supra,* at 124-25.

The Utah Supreme Court's holding on this point was especially sound in this case in light of the fact that in the past Mountain Fuel has actually been selling gas from its non-utility accounts to its utility accounts at market prices, and then passing on those market prices as an expense in rates to Utah ratepayers. The commerce clause under this Court's doctrine does not proscribe a state from putting a stop to that kind of practice.

(b) Mountain Fuel's argument that the roll-in of oil properties and profits obstructs commerce is based on a fundamental misstatement of the Utah Supreme Court's decision. Mountain Fuel misrepresents the court's holding by arguing that it regulates production, prices and profits on interstate sales of crude oil developed in states other than Utah. That is false. On the contrary, all the Utah Supreme Court held with regard to Mountain Fuel's oil profits is that net profits

beyond all costs associated with production, including the cost of capital, from oil developed as a utility activity at the sole risk of ratepayers, should benefit Utah's ratepayers. This is rate-making, not regulation of production, price or profit.

Mountain Fuel's contention that the roll-in of oil properties and profits violates the commerce clause because oil is developed and sold outside Utah is again contrary to the doctrine of this Court. This Court has squarely held that the commerce clause does not prohibit a state, in establishing utility rates, from classifying as utility properties for rate-making purposes properties located in other states. In *Lone Star Gas Co. v. Texas, supra,* this Court upheld, without requiring segregation of out-of-state properties from the rate base or segregation of revenues and expenses associated with those properties, an order of the Texas Railroad Commission reducing natural gas rates charged by a Texas utility.

> This was not a case where the segregation of properties and business was essential in order to confine the exercise of state power to its own proper province [citation omitted]. Here, as we have seen, the Commission in its method of dealing with the property and business of appellant as an integrated operating system did not transcend the limits of the state's jurisdiction or apply an improper criterion in its determinations. *Lone Star Gas Co., supra,* at 241.

Cf. Capital Transit Co. v. Public Utilities Commission of D.C., 213 F.2d 176, 179-81. (D.C. Cir. 1953).

Not only is Mountain Fuel's argument wrong as a matter of this Court's doctrine, but it flies in the face of

regulatory reality. It is both necessary and common for public utilities throughout this country to utilize out-of-state properties to provide services to consumers in their state of service. For example, Pacific Gas & Electric Company, in serving energy to California consumers, explores and develops oil and gas properties in Alaska.[8] Mountain Fuel itself explores for and develops hydrocarbons in Wyoming and Colorado for the purpose of providing natural gas to ratepayers in Utah. Because out-of-state properties are necessary to provide utility services, state public utility commissions have to include these properties in rate base and calculate rates on the basis of revenues and expenses from them. Mountain Fuel's commerce clause argument would have the effect of handicapping utilities in developing adequate sources of power to serve their consumers, and would handicap utility commissions in exercising the regulatory powers they need to set rates. Therefore, not only is Mountain Fuel's argument contrary to this Court's doctrine, but it would have the effect of stripping public commissions of power they use as a matter of course on a day-to-day basis. Mountain Fuel's position that this common practice violates the commerce clause is constitutional nonsense.

(c) Mountain Fuel's final claim the decision below burdens interstate commerce is based on the totally false premise that the holding of the Utah Supreme Court will regulate as public utilities independent

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[8] **See, e.g., Re Pacific Gas & Electric Co., 97 P.U.R.3d 321 (Cal. Pub. Serv. Comm'n. 1972), where the California Commission gave ratepayers the benefits in rates of profits on oil discovered by the utility in Alaska.**

parties jointly exploring with Mountain Fuel and will regulate interstate gas sales between independent parties and Mountain Fuel. These premises are categorically false and are a misstatement of the Utah Supreme Court's holding. The issues in this case solely concern Mountain Fuel and its wholly-owned subsidiary, Wexpro, and the court's decision makes no holding and has absolutely no ramifications with respect to independent parties.

3. *The Utah Supreme Court's decision does not raise any issue of preemption.*

Mountain Fuel's claim that the Utah Supreme Court decision regulates both oil and gas in conflict with federal statutes and policy is also nonsense. Mountain Fuel attacks both the court's decision prohibiting Wexpro to make a profit on its sales of gas to Mountain Fuel at ratepayer expense, and the holding benefiting ratepayers by rolling in oil profits on utility properties explored and developed at ratepayer risk. Neither of these holdings is remotely preempted by any federal statute, regulation or policy.

Mountain Fuel claims the Natural Gas Act preempts the Utah Supreme Court's holding preventing Mountain Fuel from passing on in rates any more than the cost of service on natural gas it obtains from Wexpro. In making this argument, Mountain Fuel misanalyzes the Utah Supreme Court's decision. The decision does not regulate wholesale prices, but prohibits profits on wholesale sales between Mountain Fuel and its wholly-owned subsidiary, Wexpro, from being

charged to ratepayers in the retail price of gas. This action is fully consistent with this Court's holdings on this very point. Contrary to Mountain Fuel's position, the Natural Gas Act left it to the states to do exactly what the court below mandated. Prior to the passage of the Natural Gas Act, this Court held consistently and squarely the states had constitutional power to regulate charges in retail rates for natural gas purchased from affiliates, regardless of whether or not the gas was purchased from the affiliate in an interstate transaction. *Western Distributing Co., supra; Dayton Power & Light Co., supra; Lone Star Gas Co., supra.* The Natural Gas Act had no effect on that authority. *Panhandle Eastern Pipeline Co. v. Michigan Public Service Commission*, 341 U.S. 329 (1951); *Panhandle Eastern Pipeline Co. v. Public Service Commission of Indiana*, 332 U.S. 507 (1947). The Natural Gas Act "had no purpose or effect to cut down state power." *Panhandle v. Indiana, supra,* at 517. The Natural Gas Act was not intended and could not have been intended by Congress to render states helpless to protect consumers against affiliated companies' price manipulations, when the Court prior to the Act had held the states had clear power to provide consumers such protection. This Court stated in *Panhandle v. Indiana, supra*, with respect to the Act:

> [P]erhaps its primary purpose was to aid in making state regulation effective, by adding the weight of federal regulation to supplement and reinforce it in the gap created by the prior decisions. The Act was drawn with meticulous re-

gard for the continued exercise of state power, not to handicap or dilute it in any way.

* * * *

It would be an exceedingly incongruous result if a statute so motivated, designed and shaped to bring about more effective regulation, and particularly more effective state regulation, were construed in the teeth of those objects, and the import of its wording as well, to cut down regulatory power and to do so in a manner making the states less capable of regulation than before the statute's adoption. *Id.* at 517-19.

Therefore, Mountain Fuel's argument that Utah is constitutionally required to allow its natural gas public utility's stockholders to make a profit at ratepayer expense on gas "purchased" from its wholly-owned subsidiary is simply wrong.

Mountain Fuel argues that the entire decision of the Utah Supreme Court is preempted by "federal regulation [which] has been extended to completely eclipse state regulation in this field." (Petition at 25.) Mountain Fuel cites a string of federal statutes, including the Natural Gas Act, in support of this fatuous proposition (Petition at 24, n. 11). But federal statutes have not eclipsed the field and "ousted" state regulation. The very statutes cited by Mountain Fuel belie that proposition. Congress has expressly recognized in these statutes the traditional powers of the states over oil and gas matters. The absurdity of Mountain Fuel's position is seen, for example, in the Public Utility Regulatory Policy Act of 1978, 15 U.S.C. §§ 3201, *et seq.* (1978). That statute expressly provides:

Nothing in this chapter prohibits any State regulatory authority or nonregulated gas utility from adopting, pursuant to State law, any standard or rule affecting gas utilities which is different from any standard established by this chapter. 15 U.S.C. §3208.[9]

There is no pattern of Congressional law "eclipsing the field." In fact, Congress has demonstrated its intent not to do so. Nor is there any conflict between any federal policy, statute or regulation and the holdings of the Utah Supreme Court. The Utah Supreme Court does not in any way regulate production, price or profit of oil or gas. It rather articulated and implemented uniformly accepted principles of ratemaking. Allocation of profits according to the principle gain follows risk is not regulation of production, price or profit. Mountain Fuel necessarily misstates the holdings because it realizes an accurate reading of the decision raises no federal issue of any sort.

Once again, Mountain Fuel's position flies in the face of regulatory reality. Mountain Fuel would have this Court eliminate all classes of state regulation over any aspect of the oil and gas business. It would eliminate state regulation preventing waste of oil and gas. It would eliminate state regulation promoting conservation. It would eliminate state boards with the juris-

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[9] **See also** the Federal Energy Petroleum Allocation Act, cited by Mountain Fuel, which again demonstrates Congress' recognition that federal regulation has not "completely eclipsed" the field. This Act, by its express terms, preempts only state regulation over allocation of refined petroleum products which are in actual conflict with regulations promulgated pursuant to it. 15 U.S.C. §755(b).

diction and authority necessary to promote conservation. It would eliminate state laws requiring well permits and the spacing of wells.[10] The argument is simply untenable.

Mountain Fuel states that the Utah Supreme Court's decision frustrates federal policy by "siezing profits" on Wexpro's oil sales because Mountain Fuel's "exploration and development program will be compelled to phase out and end." (Petition at 26.) This is nothing more than a thinly-veiled temper tantrum by Mountain Fuel's stockholders who threaten to end their exploration program if they do not get their own way. But a temper tantrum does not produce a federal constitutional issue. Mountain Fuel's contention the decision eliminates price incentives in violation of federal policy is wholly inaccurate. Price incentives are not eliminated by the decision. Mountain Fuel has always been free, and still is free, to engage in a free-enterprise oil and gas exploration program of its own. Mountain Fuel has the same price incentives as any other company. All it needs to do is put its stockholders' money at risk, rather than use the profits generated by its utility program to foster the enterprise. Nor is the threat to end the program credible, because this temper tantrum cannot limit Mountain Fuel's obligations under Utah law to serve as a public utility under Utah's regulatory authority.

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[10] **See, e.g., §§ 40-6-1, et seq., U.C.A. (1953).**

Finally, the claim that this decision will invite other states to "sieze profits" from utilities rings hollow. The Utah Supreme Court was faced with a wholly-unique problem. No other utility in this country ever developed this unique system of classification to give its shareholders the best of both worlds in its exploration and development of oil and gas at the expense of ratepayers. Mountain Fuel's conduct was unique and the decision will not have the ramifications claimed by Mountain Fuel. Mountain Fuel's claim that this abuse of Utah consumers rises to the level of constitutional principle warrants no consideration by this Court.

CONCLUSION

The Petition for Writ of Certiorari should be denied.

DATED this 28th day of November, 1979.

Respectfully submitted,

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IN THE SUPREME COURT OF THE UNITED STATES

MOUNTAIN FUEL SUPPLY COMPANY, WEXPRO COMPANY, and ALEX OBLAD, HAROLD BURTON, and CARLYLE HARMON,	:	ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF UTAH
Petitioners,	:	October Term, 1979
v.	:	No. 79-604
UTAH COMMITTEE OF CONSUMER SERVICES and UTAH DEPARTMENT OF BUSINESS REGULATION, DIVISION OF PUBLIC UTILITIES,	:	CERTIFICATE OF SERVICE OF RESPONDENTS' BRIEF IN OPPOSITION
Respondents.	:	

The undersigned attorney, who is a member of the bar of this Court, hereby certifies, pursuant to Rule 33 of the Rules of the Supreme Court of the United States, that on this 27th day of November, 1979, copies of the attached Brief in Opposition to Petition for Writ of Certiorari were duly served on the Petitioner by depositing three (3) copies thereof in the United States mail, with postage prepaid, addressed to counsel of record at their addresses listed below:

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